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BEFORE THE ARIZONA CORPORATION COMMISSION

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WILLIAM A. MUNDELL
CHAIRMAN

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COMMISSIONER

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AZ CORP COMMISSION
DOCUMENT CONTROL

IN THE MATTER OF THE MOUNTAIN PASS
UTILITY COMPANY'S APPLICATION FOR
APPROVAL OF FINANCING.

Docket No. SW-03841A-01-0166

RUCO'S COMMENTS

INTRODUCTION

On February 26, 2001, Mountain Pass Utility Company ("Mountain Pass" or "Company") filed an application for authorization of financing ("Application") requesting that the Arizona Corporation Commission ("ACC" or "Commission") approve the issuance of up to \$7,200,000 of new common stock. The Company stated in its Application that the proceeds from the stock issuance would be used to cover \$66,599 in operating losses and to finance wastewater utility plant, and related infrastructure, totaling \$7,133,401 (rounded). Under Mountain Pass' proposal, 100 percent of utility plant assets will be financed by common equity as opposed to a combination of equity, debt and/or advanced or contributed funds from developers that are involved in construction projects within the Company's service territory. On March 30, 2001, the Residential Utility Consumer Office ("RUCO") filed an Application to Intervene in the proceeding. The ACC granted intervener status to RUCO on April 11, 2001. ACC Staff filed its report ("Staff Report") regarding Mountain Pass's Application on November 6, 2001. The purpose of this filing is to comment on the conclusions and recommendations contained in the Staff Report.

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COMPANY BACKGROUND

According to the Company's Application, Mountain Pass will provide wastewater service to a total of 6,200 projected service connections in a new retirement community known as SaddleBrook Ranch. The community is located approximately thirty miles north of Tucson near Oracle in Pinal County. The Company was issued a Certificate of Convenience and Necessity ("CC&N") by the Commission in Decision No. 62757, dated July 25, 2000. According to both the Company's Application and the Staff Report, no customers are being served at the present time. Mountain Pass is an Arizona corporation that operates from its main office located in Sun Lakes, Arizona. Information contained in the Company's CC&N application, filed with the Commission on February 24, 2000, confirms that the Company's officers are affiliated with Robson Communities, the principal developer of SaddleBrook Ranch.

RUCO'S PURPOSE FOR INTERVENTION

RUCO's purpose for intervening in this proceeding is to insure that developer/owners of water and wastewater utilities, like the developers of SaddleBrook Ranch, use some amount of cost-free financing, such as advancements or contributions in aid of construction ("AIAC" or "CIAC") to finance portions of utility plant that will be used to provide service to speculative developments, as opposed to 100 percent equity financing.

The use of AIAC or CIAC has the effect of reducing the dollar amount of rate base, or the total amount of invested capital, on which a return can be earned by a utility. This has a direct impact on the rates paid by all classes of consumers. AIAC or CIAC is often provided to utilities by third-party developers in order to shift the risks associated with the costs of infrastructure serving speculative developments (that may never achieve their expected levels of home sales) from the utility to the developer. Developers have the opportunity to recover

1 AIAC and CIAC in the price of their new homes. The use of AIAC or CIAC prevents utility
2 customers from having to pay for investment made to benefit future customers.

3 RUCO's actions in this matter draw support from ACC Decision No. 61226, dated
4 November 25, 1998 that granted a CC&N to Picacho Water Company ("Picacho"). In that
5 decision, the Commission stated that it expected Picacho to consider RUCO's
6 recommendations to utilize AIAC and CIAC as a form of cost free financing, in lieu of
7 company-proposed 100 percent equity financing, when it files for financing authorization with
8 the ACC. RUCO believes that consideration of AIAC and CIAC financing should also be
9 applied in this proceeding given the similarities in the two cases.

10 **RUCO'S COMMENTS ON ACC STAFF'S REPORT**

11 RUCO concurs with, and fully supports, the conclusions and recommendations that are
12 contained in the Staff Report. RUCO believes that ACC Staff's recommendation regarding the
13 use of AIAC to fund initial collection system assets valued at \$1,500,000 is both prudent and
14 appropriate. RUCO further agrees with ACC Staff's conclusion that the financing of \$66,599 in
15 operating losses is unlawful under the provisions of A.R.S. § 40-301 and § 40-302. RUCO
16 supports ACC Staff's recommendation to allow the Company to use \$70,000 in funds from the
17 Company-proposed stock issuance for working capital purposes.

18 **CONCLUSIONS AND RECOMMENDATIONS**

19 RUCO recommends that the Commission adopt the recommendations contained in the
20 Staff Report on Mountain Pass Utility Company's Application for Authorization of Financing.

21 RESPECTFULLY SUBMITTED this 26th day of November, 2001.

22
23
24


Scott S. Wakefield
Chief Counsel

1 AN ORIGINAL AND TEN COPIES
2 of the foregoing filed this 26th day
3 of November, 2001 with:

4 Docket Control
5 Arizona Corporation Commission
6 1200 West Washington
7 Phoenix, Arizona 85007

8 COPIES of the foregoing hand delivered/
9 mailed this 26th day of November, 2001 to:

10 Lyn Farmer
11 Chief Administrative Law Judge
12 Arizona Corporation Commission
13 1200 West Washington
14 Phoenix, Arizona 85007

15 Christopher Kempley, Chief Counsel
16 Legal Division
17 Arizona Corporation Commission
18 1200 West Washington
19 Phoenix, Arizona 85007

20 Ernest Johnson, Director
21 Utilities Division
22 Arizona Corporation Commission
23 1200 West Washington
24 Phoenix, Arizona 85007

Mr. James Poulos
Mountain Pass Utility Company
9532 East Riggs Road
Sun Lakes, Arizona 85248

By Linda Reeves
Linda Reeves

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ORIGINAL

MEMORANDUM



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AZ CORP COMMISSION
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TO: Docket Control

FROM: Ernest G. Johnson, Esq.
for Director
Utilities Division

DATE: November 6, 2001

RE: STAFF REPORT FOR MOUNTAIN PASS UTILITY COMPANY'S
APPLICATION FOR APPROVAL OF FINANCING (DOCKET NO. SW-
03841A-01-0166)

Attached is the Staff Report for Mountain Pass Utility Company's application for approval of financing. Staff recommends partial approval, as modified by Staff, without a hearing.

EGJ:JMR:rdp

Originator: Joel M. Reiker

Arizona Corporation Commission

DOCKETED

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Service List for: Mountain Pass Utility Company
Docket No. SW-03841A-01-0166

Mr. James Poulos
Mountain Pass Utility Company
9532 East Riggs Road
Sun Lakes, Arizona 85248

Mr. Scott Wakefield, Chief Counsel
RUCO
2828 North Central Avenue, Suite 1200
Phoenix, Arizona 85004

Mr. Ernest G. Johnson, Esq.
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Mr. Christopher Kempley, Esq.
Chief, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Lyn Farmer, Esq.
Director, Hearing Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

MOUNTAIN PASS UTILITY COMPANY
DOCKET NO. SW-03841A-01-0166

APPLICATION
FOR AUTHORIZATION OF FINANCING

OCTOBER 2001

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION.....	1
BACKGROUND.....	1
PURPOSE OF THE PROPOSED FINANCING	1
STAFF ANALYSIS	2
CONCLUSIONS AND RECOMMENDATIONS	3

Attachment

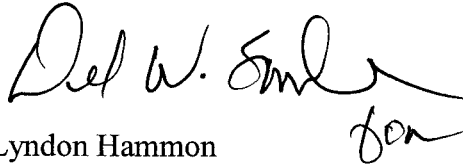
Engineering Memorandum

STAFF ACKNOWLEDGMENT

The Staff Report for Mountain Pass Utility Company, Docket No. SW-03841A-01-0166, was the responsibility of the staff members listed below. Joel M. Reiker was responsible for the review and analysis of the Company's application for financing approval. Lyndon Hammon was responsible for the engineering analysis of the proposed projects.

A handwritten signature in black ink, appearing to read "Joel M. Reiker".

Joel M. Reiker
Senior Rate Analyst

A handwritten signature in black ink, appearing to read "Lyndon Hammon".

Lyndon Hammon
Utilities Consultant

Introduction

On February 26, 2001, Mountain Pass Utility Company ("Mountain Pass" or "Company") filed an application requesting authorization to issue up to \$7,200,000 in stock equity to the shareholders of the Company. The proceeds of the proposed stock issuance are to be used to fund the Company's initial sewer infrastructure. Public notice of the proposed transaction was published on February 24, 2001.

Background

The Arizona Corporation Commission ("Commission") granted Mountain Pass a Certificate of Convenience and Necessity ("CC&N") to provide wastewater service in Decision No. 62757, dated July 25, 2000. Decision No. 62757 also ordered Mountain Pass to file a copy of its Arizona Department of Environmental Quality ("ADEQ") Approval to Construct within 365 days of the Decision.

The Company's service area includes a proposed 2,500-acre planned residential community known as SaddleBrooke Ranch located northeast of Oracle Junction in Pinal County, Arizona, approximately 30 miles north of Tucson. The Company presently does not serve any customers. However, it is anticipated that Mountain Pass will provide wastewater services to a master planned retirement community that will have approximately 6,200 homes at build-out.

Purpose of the Proposed Financing

Funds provided by the proposed \$7,200,000 stock issuance will be used to pay for the design and construction of the Company's initial sewer infrastructure. These projects include the following:

Table 1

Capital Items	Amount
Phase I WWTP (600,000 GPD) and Recharge basins	\$4,347,000
Initial collection system	1,500,000
Initial lift stations, 2 each	300,000
Effluent lines	150,000
Land	70,000
Generator, vehicle and other equipment	65,000
Engineering and Permits @ 10%	643,200
Operating Losses	66,599
Subtotal	7,141,799
Total financing requested (rounded)	\$7,200,000

Staff Engineering has reviewed the Company's application and considers the projected designated construction costs to be reasonable and appropriate. However, the Company's proposal to finance operating losses with equity violates A.R.S. § 40-301.A. Staff acknowledges the Company's financial need for working capital. Therefore, Staff recommends that \$70,000 be authorized to be used as working capital.

Staff Analysis

The Company proposes to fund the entire \$7,200,000 via the issuance of stock equity. Hence, the Company is proposing to finance 100 percent of its initial plant with equity. According to its application, Mountain Pass ultimately desires to maintain an overall balance in its capital structure. However, because the Company believes it will not have sufficient cash flow in its beginning years to service debt, it is proposing to finance its initial sewer infrastructure with equity. The Company will seek authority to introduce long-term debt into its capital structure as the development grows.

While the Company's proposal is generally consistent with sound financial practices, it may expose Mountain Pass to unnecessary risk related to the success and growth of the master planned community. Therefore, Staff recommends that line extension items, specifically the collection system, be financed by advances in aid of construction ("AIACs").

An AIAC is a contract between a developer and a utility. An AIAC provides for the developer to finance the initial cost of a line extension. If the development is successful and the utility generates revenues from new customers on the line extension, then the utility refunds a percentage of those revenues to the developer over time. Thus, the developer retains the risk of the development being a success.

The Company's proposal to fund line extension items with equity may have a negative economic impact on ratepayers. Unlike equity, AIACs are a zero-cost source of capital. Therefore, the Company's proposal to finance line extension items with equity unnecessarily increases the capital financing costs of the line extension. By financing line extensions with AIACs, the Company could reduce its own capital requirements, rate base, and cost of service. Further, the use of AIACs to finance main extension items avoids the effect of existing ratepayers paying for both the capacity they use and the capacity that is reserved for future customers. This situation occurs when the capacity of a line extension is less than fully utilized, included in rate base, and financed by equity or debt.

Conclusions and Recommendations

Staff recommends that the Commission authorize Mountain Pass to issue up to \$5,700,000 in stock equity. This amount represents the Company's requested financing authorization of \$7,200,000, less \$1,500,000 related to the initial collection system. The Company should finance the collection system with AIACs, a zero-cost source of capital.

Based on the information provided by Mountain Pass and the above analysis, the proposed financing, as adjusted by Staff, is for lawful purposes, within the corporate powers of the applicant, is compatible with the public interest, with sound financial practices, with the proper performance by the applicant of service as a public service corporation and will not impair its ability to perform that service.

Staff recommends that Mountain Pass be authorized to issue up to \$5,700,000 in stock equity for the purposes illustrated in the following table:

Table 2

Capital Items	Amount
Phase I WWTP (600,000 GPD) and Recharge basins	\$4,347,000
Initial lift stations	300,000
Effluent lines	150,000
Land	70,000
Generator, vehicle and other equipment	65,000
Engineering and Permits @ 10%	643,200
Working capital	70,000
Subtotal	5,645,200
Total financing requested (rounded)	\$5,700,000

Staff further recommends that Mountain Pass file a copy of its ADEQ Approval to Construct within thirty days of an order in this matter if it has not already done so.

Staff does not recommend a hearing in this matter.

MEMORANDUM

DATE: July 2, 2001

TO: Joel Reiker

FROM: L. Hammon

RE: Mountain Pass Utility Financing
Docket No. SW-03841-01-0166

Background

Mountain Pass Utility company will provide wastewater collection for the proposed 6,200 lot development of Saddlebrooke Ranch, near Oracle Junction.

Wastewater treatment will be accomplished by a 1.2 million gallon per day (MGD), activated sludge process, which incorporates an anoxic reactor for de-nitrification. Additional filtration and dis-infection will treat the effluent to a tertiary level. Effluent disposal will be by golf course and landscape irrigation, and also, at a later date, by either an NPDES surface water discharge permit or by aquifer recharge through percolation basins. Based on a typical sewage flow of 185 gallons per day, for peak day during peak month, the proposed wastewater treatment plant should adequately serve the development.

Mountain Pass is requesting approval to issue up to \$7,200,000 in common stock for the following capital requirements to serve customers in the first five years:

<u>Capital Items</u>	<u>Amount</u>
Phase I WWTP (600,000 GPD) and recharge basins	\$ 4,347,000
Initial collection system	\$ 1,500,000
Initial lift stations, 2 each	\$ 300,000
Effluent lines	\$ 150,000
Land,	\$ 70,000
Generator, vehicle and other equipment	\$ 65,000
Engineering and Permits @ 10%	\$ 643,200
Operating Losses	\$ 66,599

Subtotal	\$ 7,141,799
Total financing requested (rounded)	\$ 7,200,000

The above estimated capital costs appear to be reasonable and appropriate.

If it is necessary to allocate engineering and permit costs, then those costs should be allocated proportionately by project cost to the first four capital categories (treatment plant, effluent lines, lift stations, and collection lines).

The treatment of "operating losses" is deferred to the judgement of accounting and rates.

AZ Dept of Environmental Quality compliance

Mountain Pass does not have any plant facilities in operation, and therefore there is no ADEQ compliance status at this time.